

Our laws can help Japan's investors

▶ Japanese businesses can leverage the double taxation avoidance pact with Singapore.

Vivek Kathpalia
Huzefa Tavawalla
Ajay Chandru

The Indian Prime Minister on his current visit to Japan has said "a stronger commercial partnership between India and Japan should be the cornerstone in the relationship between the two countries". This statement only re-emphasises the strong historic relations (cultural-economic) which have been shared by the two nations. Japan's cultural relationship with India dates back to 6th Century BC when Buddhism was introduced to Japan from India. Buddhism created a link between Japan and India with monks and scholars embarking on voyages between the two countries. This which resulted in cultural exchanges between the two nations.

The trading relationship between Japan and India prior to WWII was mostly boosted by cotton trading, and post-WWII, it continued with the import of iron ore from India to Japan and export of manufactured goods from Japan to India. Japan has also been instrumental in India's growth, and India was the first recipient of the much-needed yen loans in 1957. Subsequently, Japan has been actively providing assistance to India, primarily in the form of Official Development Assistance loans.

In 1991, India liberalised its markets and since then Japanese companies have invested in India by partnering with Indian companies, or have set up their own subsidiaries. Ventures such as Maruti-Suzuki, NTT Docomo-Tata Teleservices, Toyota-Kirloskar, Max India-Mitsui Sumitomo Insurance, Hero-Honda are the success stories of the recent past.

In a survey conducted by the Ministry of Foreign Affairs of Japan in 2009 on the image



Singapore can work as an arbitrator for both countries. — AP

of Japan in India, 92 per cent of the participants responded positively when asked whether Japan is a reliable friend of India. The survey also showed that Japan is perceived by Indians as a technologically advanced, economically powerful and peace-loving country.

India-Japan economic relations were strengthened when the then Japanese Prime Minister visited India and signed the Joint Statement, "Japan-India Partnership in the New Asian Era: Strategic Orientation of Japan-India Global Partnership", in 2005.

QUASI FEDERAL SYSTEM

The signing of the Japan-India Economic Partnership Agreement in February 2011 that proposed to liberalise and facilitate bilateral trade and investment is a significant event.

Further, Prime Minister Shinzo Abe in various press statements has reflected his support and optimism about growing bilateral business relations between the two nations.

These bilateral efforts have resulted in Japan being the second largest FDI investor in India in 2012. However, there are certain key legal and regulatory issues directly affecting cross-border Japanese investments into India. An interesting difference between the

two countries on the governance front is that unlike Japan, which follows a continental civil law system, India follows a quasi-federal governance system.

Therefore, the Indian legal system is a combination of legislation and judicial precedent (case law) with the Central government and the State, both legislating on subjects as laid out in the Indian Constitution (which is similar to that of the US). There are plenty of legislations and authorities, which make the practice of Indian law both complex and well-laid out. Japanese companies would not only need to adhere to federal laws but also State-specific laws, depending upon the location of business operations.

Most Indian laws (except personal laws to some extent and the law of torts) are codified, and the courts may refer to English common law only where the statute is silent or ambiguous or there is an absence of Indian case law on the disputed point. These differences are important, as Japanese companies get overwhelmed by the varied regulations and the quasi-federal governance system.

INVESTMENT ROUTE

An important strategy for any Japanese company investing in India is to determine the

most favourable investment structure for legal, regulatory and tax purposes.

A situation of double taxation can be avoided by taking advantage of the relevant double tax avoidance agreements (DTAA). In the recent past, Mauritius and Singapore have evolved as popular routes for investing in India, as the DTAA between India and Mauritius/Singapore provides beneficial tax treatment and a capital gains tax exemption.

It has been increasingly witnessed that a lot of Japanese companies have operations or regional headquarters in Singapore and use Singapore as a hub for making downstream global investments. Thus, investments in India could be considered via Singapore. There is a substance requirement under the India-Singapore DTAA and the treaty benefits may not be availed if Singapore is used only as an intermediary investment jurisdiction.

Also, the India-Singapore DTAA requires, among other things, that a minimum amount of annual expenses in Singapore (presently SG \$200,000) needs to be undertaken by the Singapore Company immediately preceding the period of 24 months from the date the capital gains arises.

The Indian government has

implemented various schemes to provide companies in certain industries and in certain locations with extra benefits (such as Special Economic Zones). In addition, some Indian States provide special subsidies to attract foreign companies. These incentives could include (they may vary from State to State) direct and indirect tax subsidies, organised manufacturing sectors, industry clusters, single window clearances, among others.

Depending upon the business activities the Japanese companies intend to pursue in India, it would be a useful exercise to also identify the most appropriate location.

DISPUTE RESOLUTION

The courts in general are forthcoming in granting interim relief but due to a huge backlog of cases, a final order may range from 5-7 years. In such a scenario it becomes essential to explore alternative dispute resolution mechanisms.

One of the most widely adopted alternative dispute resolution mechanisms in India for cross-border transactions is arbitration. Arbitration in India can either be *ad hoc* or institutional (including international centres). Popular choices for institutional international arbitration include Singapore International Arbitration Centre in Singapore, the International Chamber of Commerce in Paris and the London Court of International Arbitration in London.

Singapore is generally preferred due to lower costs and a legal system which is similar to India for most Indian companies. It is also a preferred location for Japanese companies due to its proximity with Japan and because of an increasing presence of Japanese companies in Singapore.

Singapore and Japan are notified as reciprocating territories by India for the purposes of arbitration; any arbitral award passed from Singapore or Japan can be directly enforced in India.

According to the 2012 research conducted by the Japan Bank of International Cooperation, India was ranked by Japanese companies as the most promising long-term business destination in 2012. Further, as per the same survey, India was ranked second (closely behind China) in terms of the most promising medium-term business destination.

The authors are with Nishith Desai Associates, an international law firm.